

COMMONWEALTH OF MASSACHUSETTS  
DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

_____	)	
Cambridge Electric Light Company,	)	
Commonwealth Electric Company, Boston	)	D.T.E. 03-47
Edison Company,	)	
NSTAR Gas Company, d/b/a NSTAR	)	
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**INITIAL BRIEF OF  
THE ATTORNEY GENERAL**

Respectfully submitted,

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## I. SUMMARY

The four NSTAR companies<sup>1</sup> here ask the Department of Telecommunications and Energy (“Department”) to change its precedent for recovery of employee retirement costs, including costs for pensions and post-retirement benefits other than pensions (“PBOPs”). The Department for more than a decade has generally based rate recovery on the **cash** that companies have actually contributed to their pension and PBOP funds averaged over several years, and rejected pension and PBOP **expense** recovery.<sup>2</sup> NSTAR proposes to maintain the costs for pensions and PBOPs in its base rates and recover additional, much higher costs in a new reconciling “pension adjustment mechanism” (“PAM”), without a comprehensive review of its costs and revenues.<sup>3</sup> NSTAR, however, has not submitted any evidence that it failed to earn its allowed rate of return or that current rates are too low without recovery of the higher pension costs.

The Department should reject the proposed change because (1) it would illegally and unfairly adjust individual base rate cost items without considering the overall impact on NSTAR earnings and the reasonableness of the resulting rates for customers, and so represents disfavored “single-issue ratemaking;” (2) NSTAR has not shown that these changes are necessary to avoid financial impairment for NSTAR or any one of its distribution companies; (3) NSTAR calculates the PAM improperly and includes improper elements; and (4) NSTAR’s proposed recovery of

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<sup>1</sup> NSTAR comprises four distribution companies: Boston Edison Company, Cambridge Electric Light Company, Commonwealth Electric Company, and NSTAR Gas Company (collectively, “NSTAR” or “Companies.”)

<sup>2</sup> NSTAR seeks recovery of the booked accounting expense levels of pension and PBOPs (mostly health care costs), which vary with actuarial assumptions, interest rates and stock market values.

<sup>3</sup> NSTAR would recover approximately \$110 million through the PAM, an increase in revenues of approximately \$73 million beginning January 1, 2004. Tr. 1, p.47.

some of the deferrals from 2002 and 2003 would constitute prohibited retroactive ratemaking violating the Department's previously-ordered rate freeze.

## **II. BACKGROUND**

On November 20 and 22, 2002, NSTAR officials met with the Department to discuss accounting for pensions and PBOPs. Exh. AG-1-20, Atta. 1. On November 27, 2002, NSTAR wrote the Department seeking an accounting ruling that would permit deferral and creation of regulatory assets for both (1) the difference between the amount in rates and the book pension and PBOP expense levels and (2) the current and future amounts by which NSTAR's pension plan obligations exceed the year-end value of its trust fund assets, referred to as the Additional Minimum Liability ("AML"). Exh. AG-1-20, Atta. 2. The Department approved NSTAR's request for an accounting order as filed, reserving ratemaking issues for this hearing.

Although NSTAR twice told the Department in writing that it needed an accounting order from the Department on or before December 31, 2002, Exh. AG-1-20, Atta. 2, p.3 and Atta. 6, n.1, the Company did not accurately inform the Department regarding the need for an accounting ruling by December 31, 2002. NSTAR's financial witness now admits that an order could have been issued shortly after December 31 without a write-off. Tr.1, pp. 23-25. When asked how late the Department could have issued an order without a write-off, the witness NSTAR brought from its auditor, PricewaterhouseCoopers, testified that "[t]heoretically it would be up until the time the company filed its annual financial statements or its Form 10-K," which was March 31, and that companies can and have requested filing delays.<sup>4</sup> Tr. 1, pp. 127-129. The Department

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<sup>4</sup> As explained *infra*, the Department should assign no weight to the testimony of the witness from PricewaterhouseCoopers.

should consider NSTAR's repeated provision of inaccurate information on this point and in claims of financial harm, discussed *infra*, in assessing the credibility of NSTAR's financial witness. *Fitchburg Gas and Electric Light Company*, D.T.E. 02-24/25, pp. 31-33 (2002).

NSTAR's reconciling mechanism is designed to reconcile the annual amounts booked by NSTAR under Financial Accounting Standard ("FAS") 87 and 106 with the amounts included in base rates. The PAM would have three components. Testimony James J. Judge, Exh. NSTAR-JJJ, pp. 27-37. The first component is the difference between the pension and PBOP's costs included in the Company's base rates and the three-year average of the amount that the Company has "funded" for the pension and PBOP plans. NSTAR's proposal would increase this amount by approximately \$40.4 million. Tr. 1, p. 42. The second component, the Reconciliation Amount, would recover the difference between the pension and PBOPs expense amounts included in base rates and the FAS 87 and 106 expense amounts that the Company records on its books. The difference, including any past deferrals, would be amortized and recovered over a three-year period, increasing charges to customers by approximately \$11.6 million. Third, NSTAR seeks carrying charges, based on the Company's overall pre-tax weighted cost of capital, on monies it has paid but not yet collected in rates, increasing charges to customers by approximately \$20.7 million. The sum of these three components is then added to the Reconciliation Amount from the previous periods and divided by the period's forecasted unit sales (kilowatt-hours for the electric distribution service and forecasted therms for the gas distribution business) to determine the cents per unit charge, which will be applied equally to all units sold.

On August 7, 2003, the Department denied the Attorney General's June 5, 2003, Motion

To Dismiss and Motion For A Stay, noting the “high threshold for prevailing on a motion to dismiss,” and finding that NSTAR had presented sufficient facts to state a claim and warrant further investigation.

### **III. STANDARD OF REVIEW**

There are four relevant legal standards: the single issue rate case bar, the requirement that rates be “just and reasonable”, the retroactive ratemaking bar, and Department precedent that bases pension recoveries on average cash contributions to the pension fund.

The Department generally rejects rate increases based on a single issue in isolation. *Default Service*, D.T.E. 02-40-B, p. 18 (2003). The Department has indicated that the single issue rate case bar is, though firmly enforced, prudential, not absolute. *Id.*, p. 20.

The Department, after reviewing the propriety of rates under G.L. c. 164, §94, sets rates that are “just and reasonable.” *Attorney General, et al. v. Department of Telecommunications and Energy, et al.* 438 Mass. 256, 264, n.13 (2002)

The Department generally cannot order retroactive changes to base rates. *Boston Edison Company v. D.P.U.*, 375 Mass. 1, 6 (1978); *City of Newton v. D.P.U.*, 367 Mass. 667, 677-680 (1975); *Metropolitan District Commission v. D.P.U.*, 352 Mass. 18, 26 (1967); *Consumers Organization For Fair Energy Equity, Inc. v. D.P.U.*, 368 Mass. 599, 602, 605, n.8, 612, n.19, (1975)(electric fuel charge).

The Department for over a decade has generally based pension cost recovery on average cash contributions to the pension fund, not on booked accounting expense levels. *Fitchburg Gas and Electric Light Company*, D.T.E. 02-24/25, p. 111 (2002); *Commonwealth Electric Company*, D.P.U. 89-114/90-331/91-80 Phase One, pp. 65-66 (1991); *Western Massachusetts Electric*

*Company*, D.P.U. 88-250, pp. 67-72 (1989); *Western Massachusetts Electric Company* D.P.U. 87-260, pp. 39-47 (1988).

#### IV. ARGUMENT

##### A. The Department Should Reject This Request To Engage In Disfavored Single-Issue Ratemaking.

NSTAR is asking the Department for an increase in the rates it charges its customers to recover expenses and previously-incurred costs associated with a single cost area—employee post-retirement pensions and PBOPs. The Department has consistently allowed recovery of pension costs in base rates, not in a reconciling mechanism such as NSTAR now proposes.<sup>5</sup> Before removing a single cost of service expense in isolation and allowing recovery from customers through another method, however, the Department should analyze the proposed change under its bar against single-issue rate cases. The Department has not yet decided whether this case is a single-issue rate case. *NSTAR*, D.T.E. 03-47, Interlocutory Order On Motion To Dismiss, p.7, August 7, 2003. It indicated that “[t]he term ‘single-issue rate case’ is generally understood to mean the investigation of a petition for base rate relief that concerns only one major issue.” *Id.* A single-issue rate case also may occur, however, where, as here, a company seeks an increase to revenues related to a base rate item, even though the company does not petition for a change to base rates.

NSTAR has not explained adequately why the Department should alter its precedent or

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<sup>5</sup> Pension and PBOPs costs are not new business costs. Utilities in Massachusetts already recover a representative level of these costs through their existing distribution rates. Testimony of James J. Judge, Exh. NSTAR-JJJ, pp. 18-37. Characterizing these costs as a new reconciling charge customers must pay does not change the fact the Company proposes to increase just one category of expenses from its cost of service.

the source of authority for the creation of a reconciling mechanism that will adjust over- and under-collections for pension and PBOP costs. *Consumers Organization For Fair Energy Equity, Inc. v. D.P.U.*, 368 Mass. 599 (1975)(electric fuel charge); *compare Boston Consolidated Gas Company v. D.P.U.*, 321 Mass. 259 (1947)(historical use of gas adjustment clauses).

The Department stated recently that it “is generally indisposed to single-issue rate cases.” *Default Service Order*, D.T.E. 02-40, pp. 18-20 (2003).<sup>6</sup> The Massachusetts Supreme Judicial Court recently acknowledged the Department’s traditional refusal to engage in single-issue ratemaking. *Attorney General, et al. v. Department of Telecommunications and Energy, et al.* 438 Mass. 256, 270-271 (2002) (“Nor did the adjustment represent disfavored single-issue ratemaking. The department did not change rates to account for a cost increase in relation to a single item expense.”)

The Department explained that its policy is a “firmly enforced” prudential rule rather than an absolute bar, and the Department may make exception and allow single-issue rate adjustments in limited and extraordinary circumstances. “The judgment on such petitions is necessarily

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<sup>6</sup> The Department has rejected single-issue rate adjustments many times. *See, e.g., New England Telephone and Telegraph Company*, D.P.U. 84-267, pp. 9-13 (1985); *New England Telephone and Telegraph Company*, D.P.U. 84-238, pp. 10-11 (1985); *Boston Edison Company*, D.P.U. 92-23/92-24 (1992); *Commonwealth Gas Company*, D.P.U. 92-151, p. 4 (1992); *Mass-American Water Company*, D.P.U. 95-118, p. 175 (1995); *Housatonic Water Works*, D.P.U. 95-81, p. 3 (1996); *New England Telephone and Telegraph Company*, D.P.U. 97-18, p. 8 (1997); *Fitchburg Gas and Electric Light Company*, D.T.E. 97-115/98-120, p. 39 (1999). The Department also has allowed single-issue rate adjustments in exceptional circumstances, usually involving taxes or depreciation. *Cambridge Electric Light Company*, D.P.U. 490, p. 2 (1982)(single issue adjustment allowed for large property tax increase billed shortly after rate order); *Capital Recovery*, D.P.U. 859, pp. 6 (1982)(single issue depreciation increase allowed after federal represcription where other issues litigated only five months before filing), *but see* D.P.U. 84-267, *supra* (single issue depreciation increase denied); *Tax Reform Act*, D.P.U. 87-21-A, p. 11 (single issue “generic” and “uniform” income tax reductions ordered after federal Tax Reform Act); *Berkshire Gas Company*, D.T.E. 98-65 (1998)(single issue gas unbundling allowed); *Default Service*, D.T.E. 02-40-B, pp. 18-20 (2003).

circumstantial, concerning, as it must, the exigency of the problem and the importance of potential relief.” *Default Service Order*, D.T.E. 02-40-B, p. 20 (2003). In denying the Attorney General’s Motion To Dismiss, the Department accepted NSTAR’s allegations as true. On the evidentiary record, however, NSTAR has not shown that a single-issue rate increase is justified in these circumstances. An adjustment that would add reconciling pension and PBOP costs to amounts already in base rates would occur most accurately in the context of a general rate case and not in isolation. *See Id.*, p. 18, citing D.T.E. 99-60-A, p. 10. There is no basis in the record for the Department to approve NSTAR’s proposed single issue rate increase for one or any of the four distribution companies whose rates are at issue.

**1. NSTAR Is Requesting A General Increase In Rates That Requires Certain Procedural Safeguards Under G.L. c. 164, §94.**

The statute refers to a “general increase in rates” but does not define what constitutes such an increase. G.L. c. 164, §94. The Department has indicated regarding identical language in General Laws, Chapter 159, that where a rate formula “could cause the Company’s aggregate revenues to increase, we agree that the annual filings would most likely constitute a general increase in rates . . . .” *New England Telephone and Telegraph Company*, D.P.U. 94-50, p. 219 (1995). The proposed PAM clearly would constitute a general increase in rates under this definition; NSTAR’s aggregate revenues would increase by approximately \$72.8 million in January 2004. Tr. 1, p. 47. The PAM would also constitute a general increase in rates because it would increase rates for all or almost all of the Company’s services. *New England Telephone and Telegraph Company*, D.P.U. 84-267, p. 8 (1985) (“[t]he filing in the instant case represents a general increase in rates . . . since the proposed tariff would increase rates for almost all of the



Company's services.”)

By statute, where a gas or electric company proposes a general increase in rates, the Department must hold a public hearing and make an investigation as to the propriety of proposed rate changes. G.L. c. 164, §94. Declining costs as well as increasing costs may be at issue in a general rate case. After investigation, the Department decides whether the proposed general rate changes would be “just and reasonable.”

The Court has granted the Department substantial leeway regarding the methodology used to determine just and reasonable rates. *Attorney General v. Dep't of Pub. Utils.*, 392 Mass. 262, 268 (1984); *American Hoechst v. D.P.U.*, 379 Mass. 408, 413 (1980); *Massachusetts Elec. Co. v. D.P.U.*, 376 Mass. 294, 302 (1978). The Department, however, may not ignore the constitutional and statutory limits or the numerous court decisions requiring that rates be neither confiscatory nor exorbitant regardless of the ratemaking methods employed during the proceedings. *Washington Public Interest Organization v. Public Service Commission*, 393 A. 2d 71, 76-77 (D.C. Ct. Ap. 1978) (consumer and investor interests must be considered in setting reasonable rates), citing *Washington Gas Light Co. v. Baker*, 188 F. 2d 11, 15 (1950) *cert. denied* 340 U.S. 952 (1951)(the zone of reasonableness for rates “is bounded at one end by the investor interest against confiscation and at the other by the consumer interest against exorbitant rates”); *See Permian Basin Area Rate Cases*, 390 U.S. 747, 769 (1968) (“investor interests provide only one of the variables in the constitutional calculus of reasonableness”). The Department must carefully balance the “investor and consumer interests in permitting a reasonable return on the utility's investment.” *New England Telephone & Telegraph v. Department of Public Utilities*, 360 Mass. 443, 472 (1971)(“[T]he fixing of 'just and reasonable' rates, involves a balancing of

the investor and the consumer interests”; *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 602-603 (1944)(“Under the statutory standard of 'just and reasonable' it is the result reached not the method employed which is controlling”); *Bluefield WW & Improvement Co. v. Public Service Commission*, 262 U.S. 679, 692-93 (1923) (a company has no right “to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures.”)

The Department should review, at a minimum, a company’s earnings before ordering a general rate increase, in order to determine whether that increase is needed to ensure reasonable compensation. NSTAR’s proposal does not contemplate any review of the company’s current earnings, either in this case or in future PAM reviews. NSTAR has not provided any earnings data to support its proposed general rate increase.<sup>7</sup> Nor has NSTAR presented the general rate case data that the Department usually requires: a test year cost of service with *pro forma* adjustments, cost of equity, cost of service studies, etc.

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<sup>7</sup> While existing rates are presumed to be reasonable until changed, that presumption may not apply forever and does not apply to proposed rate increases. The Department has not conducted a general rate case review for any of the NSTAR companies in ten years. *Cambridge Electric Light Company*, D.P.U. 92-250 (1993); *Boston Edison Company*, D.P.U. 92-92 (1992); *Commonwealth Gas Company*, D.P.U. 91-60 (1991); *Commonwealth Electric Company*, D.P.U. 89-114/90-331/91-80 Phase One, (1991). The Department should not rely on stale data to presume in 2003 that existing rates, much less proposed increased rates, would be just and reasonable and necessary to obtain reasonable compensation. *Attorney General v. Comm’r of Insurance*, 370 Mass. 791, 799 (1976) (“We may note that if an average over a longer period would produce a result less subject to fluctuation, it might do so at the expense of using data that could be regarded as obsolescent or stale.”); *Berkshire Gas Company*, D.T.E 01-56, p. 32 (2002) (year old data too stale for unbilled revenue adjustment); *Investigation by the Department of Telecommunications and Energy on its own Motion to Establish Guidelines for Service Quality Standards for Electric Distribution Companies and Local Gas Distribution Companies Pursuant to G.L. c. 164, § 1E*, D.T.E. 99-84 (2000) (requirement that benchmarks not be based on stale data).

**2. If The Department Allows The Company To Shift Pension and PBOP Volatility Risk To Ratepayers Through The Proposed PAM, Then It Should Make A Corresponding Reduction To Rates For All NSTAR Distribution Companies To Reflect The Lower Cost Of Common Equity.**

Since the Department already includes pension and PBOP costs in base rates, NSTAR's allowed return on equity includes compensation for this operating risk. NSTAR's proposal, by itself, would decrease the Company's cost of capital, including its cost of equity, since it would shift the risks of the changes in pension and PBOPs costs from the shareholders to ratepayers. The Attorney General's expert witness, David Effron, testified that: "[i]t would be inappropriate to incorporate the proposed PAM without an adjustment to the cost of service to recognize the reduced risk of the NSTAR common equity." Exh. AG-2, p.6. NSTAR's proposal is deficient because it does not propose any reduction to the cost of equity that has occurred since the last base rate case for each of the Company's distribution subsidiaries. Proposed Tariffs M.D.T.E. 109, 209, 309, 406.

The Department does not have in the record, nor will it have under NSTAR's proposal for future reviews, any evidence showing that NSTAR's earnings with this proposed rate increase would be within the fair or reasonable range or that rates would be just and reasonable. To the contrary, Mr. Effron calculated that NSTAR earned a return on average common equity of 14.00 % in 2002 (after eliminating the effect of the write-down of the RCN investment) before any PAM increase. Exh. AG-2, Sch. DJE-1. NSTAR has continuously earned above its allowed return on common equity for each of the last three years. Exh. AG-1, 2002 Annual Report to shareholders, page 59; Exh. AG-2, p. 8.

Mr. Effron stated regarding NSTAR's earned return that, "I believe this to be well in

excess of the return on common equity that the Department would authorize in a rate case, based on current market conditions.” Indeed, the Department has found in its most recent decisions that the cost of common equity for both electric and gas distribution companies is at most 10.5 percent, a conservatively high estimate of the their cost of common equity. *Berkshire Gas Company*, D.T.E. 01-56, pp. 118-119 (finding a 10.5 percent return on common equity was in the range of reasonableness for a gas distribution company) and *Fitchburg Gas & Electric Light Company*, D.T.E. 02-24 / 02-25, pp. 229-231 (2002) (finding that a 10.0 percent return on common equity was within the range of reasonableness for both an electric distribution company and a gas distribution company). Mr. Effron concluded, “[p]ut simply, NSTAR should not be allowed to impose a rate increase on its customers by means of a new automatic adjustment mechanism when it is possible that a complete revenue requirement analysis might establish that a rate decrease is warranted.” Exh. AG-2, p. 8.

Since the 10.5 percent cost of equity for distribution companies is 350 basis points below NSTAR’s earned return on common equity during 2002, the Department should order NSTAR to reduce rates to reflect its overearnings. The average balance of common equity during the test year was \$1,280,951,000.<sup>8</sup> The after-tax effect of the change in the cost of equity is \$44,833,000 and the pre-tax change is \$73,769,000.<sup>9</sup> Therefore, if the Department allows an adjustment to

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<sup>8</sup> For 2002, the beginning of the year balance of common equity was \$1,262,596,000 and the end of the year balance was \$1,299,305,000. Therefore, the average balance was \$1,280,951,000 [  $(\$1,262,596,000 + \$1,299,305,000) / 2$  ]. See Exh. AG-2, Schedule DJE-1.

<sup>9</sup> The change in the return on common equity will be the 350 basis points or 3.5 percent times the average balance of common equity of or \$44,833,000 [  $\$1,280,951,000 \times 0.035$  ] and the pre-tax amount is determined by dividing this after-tax amount by one minus the combined federal and state tax rates or \$73,769,000 [  $\$44,833,000 / (1 - 0.39225)$  ].

rates for the Company's PAM, it should also reduce the Company's rates by a larger amount, a minimum of \$73.769 million to reflect the reduction in revenue requirements for its distribution companies.

**B. NSTAR Has Not Shown That Its Proposal Is Necessary To Avoid Financial Impairment.**

The Company claims that the PAM, as a reconciling mechanism, would address the volatility of pension and PBOP costs and mitigate potential financial impairment resulting from that volatility. Exh. NSTAR-JJJ-1, pp. 2-3. The Company, however, has not provided (1) any measurement of the volatility of pension and PBOP costs; (2) any measurement of how the magnitude of changes in these expenses relate to overall revenue requirements; (3) any principled distinction between the magnitude or volatility of pension and PBOP costs and other costs for which there is no adjustment mechanism; or (4) any data or analysis that establishes the potential for the volatility of the pension and PBOP expense to impair its financial integrity. Exh. AG-2, pp. 5-6. Mr. Effron stated that:

While it is true that changes in those assumptions can cause pension and PBOP expenses to fluctuate, just about all other expenses included in the Company's base rate cost of service are also subject to fluctuation. The Company has not explained why pension and PBOP costs should be treated differently from these other expenses that go into the base rate revenue requirement. Further, the Company has not presented any analysis showing that the fluctuations in pension and PBOP costs are of such a magnitude that they have the potential to impair its financial integrity.

*Id.*

The Company's financial witness, James Judge, speculated that NSTAR will face financial impairment without the PAM because it would have to take a charge to equity, through other comprehensive income, of the "Additional Minimum Liability." Exhibit NSTAR-JJJ, pp. 14-16. Mr. Judge's speculations are totally unfounded and contrary to the evidence. The bond rating

agencies assessed NSTAR's distribution companies as Strong "A" rated companies before the recent change in pension costs. Exh. AG-1-47. Through the recent declining markets and recession, the Companies' bond ratings did not fall, nor were the Companies placed on the credit watch list subject to falling ratings. *Id.* In fact, while their bond ratings have remained high, the Companies' costs of capital have fallen to the lowest level in over forty years. *Id.*; Tr. 1, p. 70.

Equity write-offs are not uncommon and do not necessarily lead to financial impairment. Boston Edison Company had to write off equity of over \$200 million associated with its investment in an unregulated business—RCN—yet still retained its "A" bond rating. Exh. AG-1. Mr. Judge could not cite any ratings agency that addressed pension costs as a specific concern for the Companies. Tr. 1, pp. 32 and 35. Nor could Mr. Judge cite any investment analyst that even asked the Company one question about these costs. Tr. 1, p. 35.

Nor is it clear that NSTAR would actually write-off equity absent Department approval of its proposal. The Department has always permitted recovery of reasonable and prudent pension and PBOP expenses through the cost of service, and so there is reasonable assurance that the Department will establish rates that are adequate to generate revenues that will recover those costs. Exh. AG-2, p. 9. Accordingly, pursuant to Statement of Financial Accounting Standards No. 71, Paragraph 9, the Company may book a regulatory asset to offset the Additional Minimum Liability and not have to write off the prepaid pension asset. The Department should assign no weight to the testimony to the contrary by the witness NSTAR sponsored from its auditor, PricewaterhouseCoopers. The witness admitted that his testimony was not an auditors' opinion and that he was not an expert witness. Tr. 1, pp. 115, 117.

NSTAR, therefore, has not shown that its proposal is needed to avoid financial impairment.

**C. The Department Should Reject The Proposed Pension Adjustment Mechanism Because It Includes Improper Elements, Is Improperly Calculated, and Does Not Require The Company To Make Any Contributions To The Employee Trust Funds.**

Mr. Effron testified that NSTAR's PAM is also defective in several specific ways. Exh. AG-2, pp. 9-12. The Department should reject NSTAR's proposal to recover carrying charges on the net prepaid pension and PBOP balance carried on the Company's balance sheet. The Department generally has not included prepaid pension balances relating to differences between SFAS 87 expense and cash contributions in utility companies' rate bases. Exh. AG-2, pp. 9-10. Allowing recovery of carrying charges on the prepaid pension and PBOP balance in the reconciliation mechanism would be inconsistent with the Department precedent of denying recovery in the base rates through the return on rate base. *Id.* Mr. Effron added that if the Company's present rates are adequate to provide a return on that prepaid pension and PBOP balance<sup>10</sup>, then allowing a return on that balance as a component of the PAM would provide a double recovery to the Company. *Id.* Mr. Effron also stated that NSTAR was not measuring correctly the cash required by investors to cover the difference between the actual recovery of pension expense in rates and cash disbursements to the pension plan. He explained that the prepaid pension balance reflects the difference between the pension cost pursuant to SFAS 87 and cash contributions to the pension plan, not the difference between the pension expense recovered in rates and cash contributions to the pension plan, as NSTAR proposes. Exh. AG-2, p. 10.

Mr. Effron stated that NSTAR's calculations of the pension and PBOP expense it currently

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<sup>10</sup> Based on the actual earned return on common equity in 2002, it appears that the Company's present rates do implicitly provide a return on those prepayments. Exh. AG-1, 2002 Annual Report to shareholders, page 59.

recovers in rates are “incorrect”. Exh. AG-2, p. 11. He indicated that there have been so many substantial changes since the early 1990’s, it can become extremely difficult in some instances to determine exactly what the Companies are, or are not, recovering in distribution rates. There has never really been any explicit determination of the pension and PBOP expense the Companies currently recover in distribution rates; there has not been a stand-alone distribution rate case for any of these companies. Exh. AG-2, p. 11. Mr. Effron also explained that the Companies have not adjusted the amounts they recover in rates for growth in customers, sales, or other billing determinants since the early 1990’s, when the amounts included in the total cost of service were established. Thus, to the extent that there has been system growth since the early 1990’s, the Companies have understated the pension and PBOP expenses presently being recovered through rates. NSTAR cannot calculate a PAM accurately when the amounts in rates, against which the PAM reconciles, are so uncertain.

Mr. Effron also testified that the carrying cost rates used in the calculation of the PAM factor are not proper because they reflect outdated costs of capital established years ago, not the current cost of capital. For example, the Company is proposing to use a pre-tax carrying cost rate of 15.53% for NSTAR Gas, based on that company’s authorized rate of return in D.P.U. 91-60 (1991). Mr. Effron stated that, while he is not a cost of capital expert, he is reasonably sure that a pre-tax rate of 15.53% is well in excess of the rate of return that the Department would authorize for NSTAR Gas based on current market conditions. Exh. AG-2, p. 12. Compare, 10.0% cost of equity allowed recently in *Fitchburg Gas and Electric Light Company*, D.T.E. 02-24/25, p. 230 (2002).

The Company’s proposal does not require it to make any contributions to its pensions or its



PBOPs trust funds. The PAM proposal includes an Average Differential Amount of \$40 million in addition to the amounts that the Company already collects through base rates for its pension and PBOPs costs. Exh. NSTAR-JJJ-1, p. 31. The PAM provides that “this amount will continue to be collected on an annual basis going forward until the Company establishes a new base rate amount for pension and PBOP expense.” *Id.* However, there is no requirement that the amount in base rates or this additional Average Differential Amount of \$40 million actually be contributed to the trust funds. In other words, it is free cash to the Companies that could go into NSTAR’s shareholders’ pockets.

The Department therefore should reject the PAM because it (1) may result in a double recovery of costs; (2) bases cost adjustments on indeterminable levels of recovery from customers; (3) bases carrying costs on capital costs that are clearly outdated; and (4) does not require that any of these amounts be used for cash contributions to the trust funds.

**D. The Department Should Reject The Proposed Pension Adjustment Mechanism Because Recovery of Base Rate Costs Deferred From 2002 and 2003 Would Represent Prohibited Retroactive Ratemaking, Violating A Previously-Ordered Rate Freeze.**

NSTAR is seeking recovery of expenses incurred in 2002, amortized over three years, under the Reconciliation Adjustment, and expenses incurred in 2003, under the Average Differential Amount. Exh. NSTAR-JJJ, pp. 27-37. By Department order, NSTAR is prohibited from raising rates for four years after its merger. *NSTAR Merger*, DTE 99-19 (1999). The rate freeze applies to distribution rates until September 2003. *Cambridge Electric Light Company, Commonwealth Electric Company, Boston Edison Company, Commonwealth Gas Company*, D.T.E. 99-19 at pp. 4-5, 22-28 (1999) (four year general distribution rate freeze as part of merger plan), *affirmed*,

*Attorney General, et al. v. Department of Telecommunications and Energy, et al.* 438 Mass. 256, 258 (2002) (four year freeze in distribution rates). Proposed Tariffs M.D.T.E. 109, p. 2 of 3; Exh. NSTAR JJJ, pp. 29-31.

NSTAR's petition does not explain how its proposed reconciling mechanism would comply with the requirements of the merger rate freeze. The Company has not demonstrated any type of revenue deficiency that would entitle it to file a request for an increase in base rates during the freeze period. *NSTAR*, D.T.E. 99-19, at pp. 86, 94. The new pension benefit reconciliation mechanism does not qualify as an exogenous cost under the merger rate plan since the drop in the stock market which largely prompted NSTAR's petition did not "uniquely effect" the electric and gas distribution industry. *NSTAR*, D.T.E. 99-19, p. at 35. Every company pension fund is structured differently and has been effected by the recent stock market volatility in different ways.

The Department noted that NSTAR was not proposing its first rate increase until four months after the rate freeze ends on September 30, 2003, and indicated that the freeze does not prevent "mounting proposals before that date, to be effective after that date." *NSTAR*, 03-47, Interlocutory Order Denying the Attorney General's Motion To Dismiss, p.10, August 7, 2003. The issue, however, is not so much increases proposed during the rate freeze for collection after the rate freeze, but collection of costs after the freeze that were incurred during the rate freeze. NSTAR proposes to recover amounts incurred during the freeze period, charging its customers additional amounts above the level it had agreed to freeze and the Department had ordered to be frozen.

Under Department precedent, moreover, a utility may not defer a cost during the period covered by a rate settlement that fixes rates unless specifically allowed by the terms of the agreement. *North Attleboro Gas*, D.P.U. 93-229, p. 6 (1993) (denial of deferral request since

expense occurred during period of settlement and expense did not qualify as an exogenous cost).

Through the settlement, a company's election to limit its rates for a number of years also “forecloses its ability to file for and therefore recover rates beyond those specified” in the agreement. *Id.* It now appears that NSTAR seeks ongoing accounting deferrals for periods covered by the freeze and beyond.

The Department should not allow NSTAR to avoid the consequences of the rate freeze by surgically deferring just one element from its cost of service and then requesting recovery for it after the rate freeze period. Customers should be entitled to the whole benefit of the entire four years of fixed distribution rates, an integral part of the Department’s rationale behind approving merger rate plan, not merely deferral of rate increases. *NSTAR*, D.T.E 99-19, p. 24 (“On balance, the Department considers ratepayers to be better served by a commitment now to a four-year rate freeze than by conducting a rate case examination now of actual cost savings and cost increases.”)

The Department should not allow increases based on amounts deferred from 2002 and the first eight months of 2003 because it would represent retroactive ratemaking, in violation of the prior orders. “The rule against retroactive rate[making] prohibits . . . adjusting current rates to make up for a utility’s over- or under-collection in prior periods.” *Towns of Concord, Norwood, & Wellesley v. FERC*, 955 F.2d 67, 71 n.2 (D.C.Cir. 1992); This general “rule that agencies may not alter rates retroactively” acts to “ensure predictability,” *Oxy USA, Inc. v. FERC*, 64 F.3d 679, 699 (D.C. Cir. 1992).

In sum, the Department also should reject the PAM because its proposed recovery of amounts incurred in 2002 and 2003 would represent retroactive ratemaking, inconsistent with rate freeze ordered in the NSTAR merger decision.

**V. CONCLUSION**

The Department should reject NSTAR's proposed pension adjustment mechanism for the reasons stated above.

Respectfully submitted,

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